

**01734**

1994/08/00

## CHINA: KEY BILATERAL ISSUES

### Background

**Intellectual Property Rights.** Although China has established a framework of laws and regulations to protect intellectual property rights (IPR) in line with the U.S.-China Memorandum of Understanding on Intellectual Property Rights, China's enforcement of these rules and regulations is sporadic at best and virtually non-existent for copyrighted works. Piracy continues to be rampant—particularly of copyrighted works and trademarks—and China also maintains a myriad of hidden quotas and non-transparent regulations that effectively keep U.S. IPR products out of the market. At senior levels, the Chinese appear to recognize that there is a problem, but we have seen only limited progress. As a result, on June 30, 1994, USTR announced China's designation as a Priority Foreign Country and the immediate initiation of an investigation under section 301 of the Trade Act of 1974.

The investigation process is moving along quickly. DUSTR Barshefsky visited Beijing in late July and USTR-led negotiations are scheduled for August 22-23 in Beijing. China must make significant progress within a six-month period (with the possibility for a three month extension) if sanctions under Special 301 are to be avoided.

**GATT.** The end of the Uruguay Round of trade negotiations and the anticipated advent of the World Trade Organization in January or June 1995 have galvanized China to press for entry into the GATT 1947 by the end of 1994 in order to be a founding member of the WTO. While this is not objectionable in principle, we support conclusion of China's accession negotiation only on terms that provide for bringing the Chinese economic and trade regimes into compliance with the GATT/WTO.

A first "reading" and discussion of the Chairman's maximalist text of Contracting Party concerns for inclusion in a draft accession protocol was held the week of June 7, 1994. A second review, at which meeting the Chinese presented their own text, was held July 28-29, 1994. China considers the maximalist text to be "unacceptable in principle" although they have participated in discussions of the issues on the basis of that text. Although there is broad disagreement in many areas of concern, a critical problem for China appears to be the unwillingness of many of the contracting parties to accord China less-developed-country status and the special dispensations that go with that status.

In addition to the protocol, China must negotiate bilaterally with its trading partners to establish its schedule of GATT tariff concessions (bindings). The United States' list of tariff requests was presented to China the week of August 12, 1994. Bilateral negotiations on this second area of concern should begin during the week of September 12, 1994.

At this time, China continues to maintain import restrictions, including licensing requirements and quota limitations, that are in many cases still not clearly understood and frequently not made public. China continues to deny national treatment to many foreign invested enterprises by not allowing them trading rights in the domestic Chinese market. There is still arbitrary and inconsistent treatment of goods imported into China at different points of entry and in the border areas. It is not at all clear that provincial and local governments comply with the market reforms that have been officially instituted by the Chinese central government. Also, despite a considerable amount of discussion of changes and reforms in China's foreign exchange system, it is still too early to judge their effectiveness.

**Export Controls.** Because MOFTEC approves only a limited number of the U.S.'s pre-license requests, delays many of them, and has not permitted post-shipment verifications, the U.S. proposed in December 1992 formalizing an end-use check arrangement. Several draft proposals have been exchanged, the most recent one on August 18. This arrangement will permit the United States to conduct more pre-license checks with less delay and, for the first time, permit the U.S. to conduct post-shipment checks in China. Information obtained from these end-use checks would facilitate the licensing of more dual-use exports to China.

This visit also provides the opportunity to discuss with the Chinese the mutual benefit of engaging in a dialogue with the U.S. on export controls and nonproliferation issues. The end of COCOM, and ongoing negotiations to establish a successor regime aimed at countries of proliferation concern, provide an incentive for the Chinese to join like-minded countries on a nondiscriminatory basis to deal with nonproliferation. Chinese membership in the post-COCOM regime will depend on their adherence to nonproliferation regime and norms, restraint in arms sales, and implementation of an effective export control system. The U.S. can provide technical assistance to Chinese government officials and hold seminars to assist China in establishing an effective export control regime.

**Financing Issues.** In various discussions prior to the JCCT in April, the Chinese made it clear that they hope to see positive developments on four main issues: (1) resumption of U.S. Trade and Development Agency (TDA) programs; (2) resumption of Overseas Private Investment Corporation (OPIC) programs; and (3) the development of a "soft loan" program with the U.S. Export-Import Bank.

MOFTEC officials will emphasize that TDA support is an important component in making our sectoral work programs more effective. TDA and OPIC activities are captured by Tiananmen sanctions and require a presidential order to restart. In his May decision on MFN, President Clinton called for the continuation of these sanctions. Resumption of OPIC also requires a Presidential determination on China's worker rights situation which OPIC believes it cannot make (especially in light of a negative finding for Korea). The private sector has asked that we consider restoring OPIC programs on a case-by-case basis. A "soft loan" window for China, or any other country, is also not possible. Eximbank will aggressively match tied aid offers by other governments in selective situations. Projects must be environmentally and developmentally sound and potential U.S. sales should be strongly competitive and offer follow-on market penetration.

**Textiles.** On January 17, 1994, the United States and China signed a new three year textile and apparel agreement. The United States was successful on obtaining a stronger anti-circumvention provision for dealing with fraud and illegal transshipments. This agreement also establishes new quotas for several textile articles and reduces annual growth in textiles and apparel quotas from China to one percent. A separate agreement between the United States and China was recently concluded to establish for the first time limited on silk apparel exports to the United States. In addition, an Electronic Visa Information System (ELVIS) is in the initial stages of development.

In meetings June 9-10, the United States reviewed evidence that goods shipped to the United States as products of Australia, the Maldives, and the Dominican Republic were actually products of China and informed Chinese officials that charges to Chinese quotas would be made based on the evidence presented. The Chinese were formally notified in letters dated July 1, that the charges would be made immediately.

Group II from China closed on August 16, 1994. Although the Chinese submitted a request for five percent additional quota on August 17, the request could not be processed since it did not specify an eligible Group limit from which to deduct the increase. As soon as Chinese officials submit a revised request for the increase which specifies an eligible donor Group, we will take action to re-open the Group.

**Textiles Rules of Origin.** An amendment to the Uruguay Round implementing legislation was introduced in both the House and Senate which would fundamentally alter the way in which U.S. Customs determines the country of origin of imported wearing apparel and therefore charges to quota. The House Ways and Means Committee passed the amendment by a vote of 24 to 12. The amendment was defeated in the Senate Finance Committee by a 10 to 10 vote. It is not clear at this time what the chances are for this amendment in conference. The amendment, which was introduced on behalf of the domestic textile and apparel industries, has the Administration's support.

Country of origin for most apparel items is currently based on where the fabric is cut into apparel parts. Assembly of the cut parts in another country does not change the country of origin. The rule of origin offered by Senator Breaux and Representative Cardin would require U.S. Customs to determine country of origin based on where the apparel is assembled, instead of where it is cut, which is the current rule for most apparel. If adopted, a rule based on assembly would have the greatest effect on Hong Kong, Korea, and Taiwan, which are becoming less competitive in apparel assembly and which utilize the loopholes in the current rule by farming out an ever-growing amount of their sewing operations to China and elsewhere. These outward processing arrangements (OPAs) have allowed large quota holders like Hong Kong, Korea, and Taiwan, which are no longer competitive in middle- to low-end apparel production, to use the large quotas they attained over the years. China's ability to utilize its quotas would not be affected, although a claim could be made for compensation on the basis that the U.S. amendment would charge to China's quotas goods which were not previously subject to it.

**Services/Business Facilitation.** China's services market is highly restricted. Although Beijing has allowed some limited experimentation in insurance, banking, advertising and accounting, further liberalization will be needed if U.S. firms are to increase their presence in the market. So far, one U.S. insurance firm and several U.S. banks have established branches in China. Early this year, a USTR-led interagency group began to pursue a broad-based services initiative with China. Initial sectors under consultation include insurance, distribution and retailing services, telecommunications services, and business facilitation issues. USTR has held two rounds of formal bilateral negotiations on services, with several more planned throughout the summer and fall. A round of negotiations will have just completed prior to your arrival in China (August 22-23).

In support of the USTR services initiative, Commerce has developed a complementary program of business development activities in key services sectors under the Business Development Working Group of the Joint Commission on Commerce and Trade (JCCT). DAS for Service Industries and Finance, Jude Kearney, recently led a highly successful insurance mission to China as part of this program. Franchising and other missions involving distribution services, information services, and marketing services are planned for the fall.

Commerce has also been actively supporting the USTR dialogue on business facilitation issues.

Improvements in the operating conditions of U.S. firms was a topic of the Trade and Investment Working Group of the JCCT in April. In addition, Commerce has presented two Non-Papers to the Chinese (cleared by USTR) regarding improvements in business conditions that China can make in the near-term and specific company problems for which we seek resolution.

**Market Access.** The U.S.-China Market Access Agreement, signed in October 1992, provides for the phased elimination of tariff and non-tariff barriers (import licensing requirements, quotas, controls, lack of transparency) which will provide greater access for more than 600 goods. Ambassador Kantor set a deadline of December 31, 1993, for China to comply with applicable provision of the market access agreement. China is now in overall compliance, although problems remain on market access for agricultural products—specifically, the sanitary and phytosanitary measures that China is using as a barrier to U.S. products. Our negotiations have yielded marked steps forward on market access for industrial goods, with China removing non-tariff restrictions on more than 842 items since the end of 1993. Another tranche of restrictions will be lifted at the end of this year. Our success has really been the catalyst for progress in the GATT on non-tariff measures.

Imports of machinery and electronics equipment in 1993 were up more than 40 percent, with significant liberalization in some categories of interest to the United States. China has also committed to make its trade regime for goods transparent, with deadlines for adherence. This is also an issue that we are pursuing as part of the GATT/WTO talks.

**Bilateral Investment Treaty.** In February 1994, all trade agencies agreed to a staged approach on investment issues with China instead of negotiating a Bilateral Investment Treaty (BIT) because many of China's policies which caused the BIT negotiations to fail in 1985 remain in place today, despite China's more open approach to foreign investment now. Furthermore, the U.S. BIT has evolved since 1985 incorporating higher standards for the treatment and protection of investment, which are expected by both the U.S. private sector and the U.S. Senate.

**Commerce Launch Services.** China is eager to negotiate a bilateral follow-on agreement to the 1989 Memorandum of Agreement (MOA) regarding international trade in commercial launch services. The 1989 agreement allowed China to enter the international market for commercial launch services under specific quantitative and pricing restrictions. China was allowed nine commercial launches over six years with the stipulation that its launch providers would bid on contracts at prices, terms, and conditions which are "on a par" with those prevailing in the international market for comparable launch services. The 1989 MOA expires at the end of 1994. The U.S. Government expects to enter into negotiations with China on commercial launch services later this year. U.S. launch service companies and agencies monitoring the 1989 agreement are concerned that recent contracts for Chinese launch services signed in the past year will not be counted under a follow-on agreement.

**Bilateral Trade Relations.** Our bilateral trade relationship in the past several years has been dominated by our large and growing trade imbalance which reached \$22.8 billion in 1993, second only to our deficit with Japan. In the first half of 1994, our imbalance reached \$11.7 billion, as compared to \$9.5 billion over the same period in 1993 (an increase of 23%). Our trade imbalance reflects a shifting of our deficit to China from Hong Kong and Taiwan, which have relocated a great portion of their manufacturing operations to the mainland. With approximately \$15 billion in

cumulative investment in 1993, the U.S. is the third largest investor in China, behind Hong Kong and Taiwan.

**Trade Data Discrepancy.** The Chinese dispute our trade statistics, asserting that goods transhipped through Hong Kong should not be counted because value-added in China is marginal. At the JCCT, the U.S. and China agreed to a study investigating the discrepancies in our bilateral trade statistics and to exchange data. Data exchange is ongoing. Census officials met with Chinese officials August 1-5 in China. Both sides have agreed to exchange research proposals by the end of September and both parties have reconfirmed their original goal of presenting a joint report by October 1995. The next meeting is tentatively scheduled for early December in the United States.

**Import Administration.** We have had a continuing increase in the number of antidumping petitions filed by domestic industries complaining about unfair imports from China--there are currently ten ongoing Chinese investigations. In each case to date involving China, the Department has determined that China is a non-market economy (NME) (i.e., state-controlled). Pursuant to the regulations regarding non-market economies, we incorporate a "factors of production" methodology in our determination of whether there is dumping.

The Chinese are concerned about our policy regarding "separate rates" for Chinese exporters. Chinese companies must prove their independence from the central government to be eligible for a separate rate. If a company is ineligible for a separate rate, it receives the same rate calculated for all other Chinese exporters, which is typically a very high rate. This results from the fact that most Chinese exporters do not cooperate in the investigation. To receive a separate rate from other exporters, a Chinese exporter must establish that it is independent from government control in export activities. The Chinese have paid particular attention to a recent case, Compact Ductile Iron Waterworks Fittings (CDIW). The Department accepted a voluntary court remand to reconsider its determination not to assign a separate rate to one Chinese company in the case, CMP.

## **CHINA: KEY BILATERAL ISSUES**

### **Talking Points**

#### **Intellectual Property Rights**

- Despite the presence of a good legal foundation in China for the protection of intellectual property rights, the absence of enforcement of those laws and regulations—especially in the areas of copyright and trademark products—has created serious problems.
- Because of the absence of effective IPR enforcement and severe market access barriers—both of which result in enormous losses to U.S. industry—Ambassador Kantor had no choice but to identify China as a priority foreign country on June 30 and initiate a Special 301 investigation.
- U.S. companies lose up to \$800 million annually to piracy of copyrighted works alone in China. This piracy has serious commercial implications for China. Not only are American companies losing money, but the piracy harms China's own companies.
- The United States wants to work constructively with China to improve IPR enforcement in China.

#### **GATT**

- U.S. "Staunch" Support of China's Accession. The United States has supported, and continues to support, the entry of China into the GATT, and into the international trading community, on terms that are appropriate to China's economic and trade system and compatible with GATT principles.
- China has approached the GATT not as a centrally planned, non-market economy, but as a country whose economic and trade system is being reformed to produce a regime that can actually adopt GATT-mandated mechanisms to regulate its trade and to achieve true market access.
- However, both China and the contracting parties (CPS) are aware that China's economic and trade system is not yet GATT compatible. A negotiated set of economic safeguards in China's protocol of accession is one of the steps which could speed CP acceptance of China's GATT membership and accelerate China's internal reform.
- LDC Treatment in GATT. China is one of the fastest growing trading nations in the world and is internationally competitive in many industrial areas. Such a large, competitive, growing and transforming trade regime cannot be regarded as a less-developed country in its GATT relations.
- China should continue to take a constructive approach to its GATT/WTO accession negotiations, understanding that commitments to further solidify China's reforms and opening to the world serve China's economic interests as much or more than they serve those of the other GATT CPS.

- **Coverage of U.S. Tariff Request List.** The United States has presented its GATT/WTO tariff request to China. This document was very carefully prepared. It is a reasonable and straightforward request representing U.S. trade interests and incorporating the harmonized tariff reductions agreed to in the Uruguay Round.
- The United States' request for comprehensive and commercially meaningful tariff reductions reflects the continuing interest of the U.S. business community in gaining access to and competing fairly in the large and growing China market.
- **"Founding" Membership in the WTO.** We are aware of China's desire to complete its GATT accession negotiations by the end of 1994, in order to qualify for "founding" membership in the WTO, which was established at the April 15 Marrakesh meeting and which we expect to be implemented at the end of this year.
- Given the size, complexity and rapidly changing characteristics of China's trade regime, and the concerns of many contracting parties about China's ability to uniformly implement fundamental GATT obligations, we do not believe that an artificial or arbitrary deadline, such as qualifying for founding membership in the WTO, should be imposed on completion of China's accession.

#### Export Controls

- The U.S. has recently liberalized export controls in ways that will increase significantly the opportunities for U.S.-China trade. This is especially apparent in the computer area, where our new general license GLX (adopted April 4, 1994) allows computers up to 1000 MTOPS and almost all telecommunications equipment to be shipped to civil end-users in China without any prior USG approval.
- A prime example of this liberalized policy is the recent shipment of a powerful computer that has been installed in the National Meteorological Center, in Beijing.
- We have also recently removed restrictions on the export of such items as reactor and power plant simulators, process control systems, and turbines-generators for use in civilian nuclear power plants.
- I believe these actions demonstrate our desire to begin a fruitful dialogue on various export control issues that will allow, in the future, for further such liberalizations.
- As you know, COCOM has ended, and efforts are underway to develop a new regime that will address the control of conventional arms and sensitive dual use technology. Membership in the new regime is non-discriminatory—that is open to all like-minded nations who adhere to appropriate nonproliferation norms (AG, MTCR, NSG), exercise restraint and transparency in conventional arms transfers, and have effective export controls.
- We would very much like to discuss our experiences in developing an effective export control system. Our specialists could begin this process immediately.



- In addition, we propose a separate initiative involving a series of seminars in China for both U.S. companies and Chinese importers. The seminars would facilitate greater understanding by the business community and help expedite the processing of U.S. export licenses for Chinese end-users. The seminars could begin in late 1994.

#### Financing Issues

- **TDA and OPIC.** We agree that both TDA and OPIC are important to furthering commercial cooperation between our two countries. The President's recent decision on China's MFN status called for the continuation of the suspension of both of these programs in China.
- **Concessionary Financing.** Under the Administration's new tied aid policy, the export-import bank (Eximbank) will consider matching foreign tied aid credits that offer prospects for serious trade distortion, if U.S. sales are strongly competitive and offer follow-on market penetration. Eximbank does not introduce tied aid into competitive situations, however, since a "first strike" policy would contradict our goal of reducing global tied aid.
- On conventional finance, given earlier project information, plus details on competitive financing offers, the USG can mobilize funds in a timely manner. Your help will be pivotal in concluding timely U.S. counteroffers.
- Eximbank's newly-created project finance division now is processing application requests for project financing in China. This program has neither a maximum nor minimum project size.

#### Textiles

- **On the Recent Transshipment Charge.** We appreciate the efforts of the Chinese Government to investigate and eliminate incidents of illegal transshipment. We presented clear evidence during talks in San Francisco that goods shipped as products of the Dominican Republic, Australia, and the Maldives were actually Chinese goods. The goods are rightly charged to Chinese quotas.
- The charges made to categories 339 and 352 were not punitive. The goods in question were shown to be made in China and are simply being charged to the correct country and category.
- We remain willing to reduce these charges if you can show evidence that these goods were not made in China.
- **On the Closure of Group II.** We will take action to re-open Group II immediately upon receiving a revised request from you. If you have any questions about the requirements for the request, please direct them to Deputy Assistant Secretary Rita Hayes.

#### Textiles (Rules of Origin)

- These amendments will bring our rules into line with Canada and the European Union, the other major apparel importing nations.
- The amendment enhances U.S. Customs' ability to detect and prevent illegal transshipment.

### Services

- China's services markets remain closed in many respects. Access in China is certainly not reciprocal, especially in areas such as insurance, business services, information services—including telecommunications services, and distribution and retail. We ask that China open these markets to U.S. companies, the most competitive in the world in many cases.

### Business Facilitation

- As our two sides move forward in establishing programs for increased bilateral commercial cooperation, we should not forget that old problems remain. While China has made great strides in developing a more favorable commercial climate, there are still a number of problems regarding the conditions under which firms must operate which impede U.S. participation in China's economic development.
- Representative offices, joint ventures, and wholly-owned ventures are plagued by limits on their authorized scope of business activity, cumbersome labor regulations, arbitrary and discriminatory fees, among others. These impediments dampen investor interest and ultimately discourage new business and investment prospects.
- Improving the operating conditions for U.S. firms—representative offices, joint ventures, and wholly-owned ventures alike—will ensure that our two countries receive the maximum benefits from the agreements we will reach during my visit to China.

### Market Access

- China's continued efforts to fully implement the market access agreement will be vital to our business development efforts and the sectoral work programs. We hope that China will continue to improve transparency and liberalize import restrictions on schedule.

### Bilateral Investment Treaty

- (If Raised) The investment principles in our bilateral investment treaties are of the highest standards. We view the investment work going on now between our two countries in various groups as an important prerequisite to a bilateral investment treaty.
- We believe completing this work will create an investment regime more closely aligned with the principles in our BIT.

### Commerce Launch Services

- The U.S. Government is interested in negotiating a follow-on agreement to the 1989 Memorandum of Agreement on commercial launch services.
- The first round of talks will be held in mid-September in Beijing and I hope we can bring the talks to an early and mutually satisfactory conclusion.

### Bilateral Trade Relations

- Bilateral trade between our two countries has reached new heights. While we are excited about the promise of increased commercial cooperation between our two countries, we are also concerned about our large and growing trade imbalance. I am hopeful that this mission and

the agreements we reach during my visit will lay the foundation for increased U.S. exports to China.

#### Trade Data Discrepancy

- I am pleased that statistical experts from our two countries are conducting a joint study to investigate differences in our trade data. The exchange of information and the establishment of a real dialogue are the first steps to understanding discrepancies in our trade data.

#### Import Administration

- **Increasing Number of Cases.** It is natural to expect that, as Chinese exports to the United States increase, the number of antidumping complaints will also increase. It would be helpful if your government would encourage exporters to respond to our antidumping questionnaires so that they are not subject to adverse findings. We also rely heavily on your government to identify the enterprises that are exporting to the United States and we continue to need your assistance in this regard.
- **Separate Rates.** Our policy on granting each company its own antidumping duty rate is evolving as the Chinese economy is evolving. We are increasingly investigate Chinese enterprises with new and different types of business structures, such as shareholding companies and partially foreign-owned companies, and we have been adapting our policy to accommodate these new forms.
- **NME Status.** We continue to view China as a nonmarket economy country. We do not view China as qualifying for economy in transition (EIT) status under legislation currently being considered by the congress because of the virtual absence of private property rights in your country.